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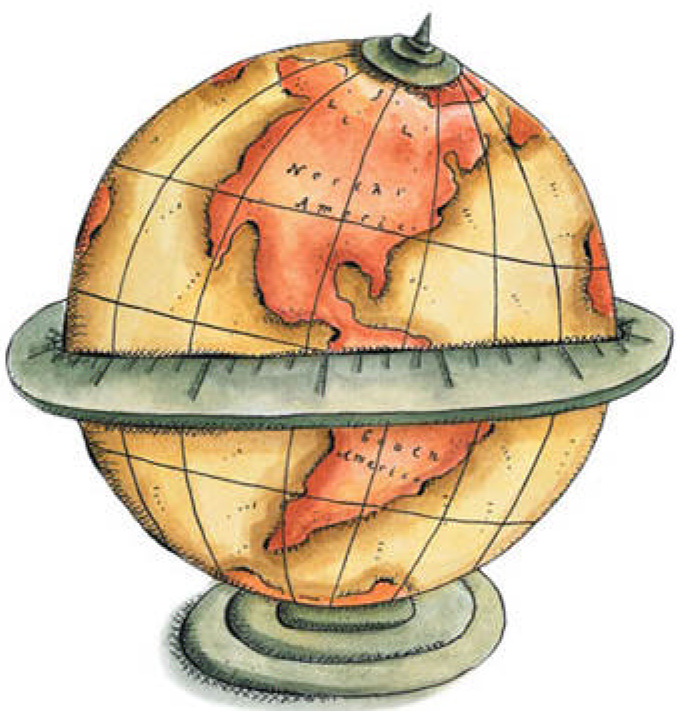
INTERNATIONAL FOCUS

Spanning the Western Hemisphere: Free Trade Area of the Americas

Negotiations are under way in 2003 to establish a free trade area that would encompass 34 countries in North, Central and South America and the Caribbean. Many of the member countries would benefit from liberalizing trade with the United States' large and dynamic economy. But a number of obstacles still need to be overcome before this trade agreement is finalized.



This year will be an important one for U.S. trade policy. Already, there have been some significant trade developments, including the signing of the U.S.-Chile free trade agreement and the beginning of talks with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua to form a U.S.-Central America free trade agreement. The United States is also a leading player in negotiations, conducted under World Trade Organization (WTO) agreements, aimed at liberalizing agricultural trade among WTO member countries by 2015.

In addition, in 2003 Brazil and the United States are the co-chairs of the negotiations for a Free Trade Area of the Americas (FTAA) that would span from Ellesmere Island, Canada, to Tierra del Fuego, Argentina. Negotiations are set to conclude by the end of 2005. If the FTAA is established, it will represent the largest trading bloc in the world. While the agreement offers many potential benefits, a number of issues must be addressed before all of the countries can reach consensus on this wide-ranging plan.

Gains from trade

According to its proponents, the FTAA will bring a number of economic benefits to its members. The trading bloc promises to make imports from the region cheaper for consumers and expand markets for exporting firms. Over time, economists expect that countries in the FTAA will begin to specialize in the materials, goods or services in which they have a comparative advantage and realize gains from that specialization. For the developing countries of the hemisphere, this agreement offers hopes of increased foreign direct investment, increased productivity, the sharing of technology, and higher wages and standards of living.

The FTAA economy

Under the agreement, the proposed 34-member region includes all the independent nations of the Western

Hemisphere except Cuba. The FTAA region will have a total population of approximately 825 million, of which 285 million (34 percent) live in the United States. The North American Free Trade Agreement (NAFTA) countries, Canada, Mexico and the United States, account for 50 percent of the area's population while the Mercosur countries of Argentina, Brazil, Paraguay and Uruguay make up 27 percent.

Location of FTAA Headquarters Still Undecided

As negotiations for the final draft of the FTAA pick up steam, a decision on the location of the FTAA headquarters is scheduled to be made in 2003. Six cities — Mexico City, Port of Spain (Trinidad and Tobago), Panama City (Panama), Houston, Atlanta and Miami — have announced their candidacy.

Atlanta and Miami are beefing up their lobbying efforts to become the FTAA headquarters. Atlanta is emphasizing its transportation structure and Miami its role as the "cultural capital" of Latin America. Up for grabs are the 200 jobs in the headquarters and the respective legal, banking, transportation and other ancillary jobs.

In economic terms, the NAFTA countries make up an even larger share of the FTAA. The United States is by far the largest economy in the region, representing 79 percent of the FTAA's total gross domestic product (GDP), which was $12.5 trillion (in U.S. dollars) in 2000. Canada and Mexico account for another 10 percent of the FTAA economy, and Mercosur, a little over 7 percent. Thus, the NAFTA and Mercosur countries make up more than 96 percent of the FTAA's economy and 77 percent of its population.

Differences in the development and structure of the various economies within the FTAA area are also evident. The United States and Canada are members of the G-7 group representing the largest industrialized countries in the world; Argentina, Brazil and Mexico also have sizable industrial bases. In contrast, several Caribbean countries, such as the Bahamas, Barbados and Jamaica, have very small economies driven almost exclusively by tourism. Also, several countries in the region have primarily commodity-based economies, such as Bolivia, Guatemala and Paraguay, where agriculture represents over 20 percent of GDP.

Western Hemisphere trade patterns

An analysis of trade patterns helps reveal the relative importance of the FTAA countries for the United States. The latest available data, from 2001, show that trade with FTAA countries makes up 44 percent of total U.S. exports and 36 percent of total U.S. imports (see table 1). But trade with NAFTA partners Canada and Mexico accounts for 36 percent of U.S. exports and 30 percent of imports, so only 8 percent of U.S. exports and 6 percent of imports is with the other FTAA countries. While trade with NAFTA is a very significant part of total U.S. trade, transactions with the rest of the hemisphere are, at this stage, considerably less important. But if history is a guide, the signing of the FTAA may increase U.S. trade with these countries. In 1991, prior to NAFTA, trade with Mexico accounted for only 9 percent of U.S. exports and 6 percent of imports. By 2001, trade with Mexico made up 14 percent of U.S. exports and 11 percent of U.S. imports.

For the other 34 members of the FTAA, trade with FTAA members as a share of total trade is significantly higher than it is for the United States, as table 2 shows. In addition, the United States is a major export destination and an important source for imports for FTAA countries. These trade patterns have significant implications for FTAA countries. The most obvious one is that some member countries could stand to benefit from the liberalization of trade with the United States, gaining access to the largest and most dynamic markets in the world. However, the fact that U.S. trade with non-NAFTA countries within the FTAA is comparatively small may add to the United States' bargaining power in the negotiations ahead. (See the sidebar for a description of the negotiations.)

TABLE 1
U.S. Export Profile in 2001

	Exports (US$ billion)	Imports (US$ billion)	Percentage of Total Exports	Percentage of Total Imports
Total	730	1,180	100	100
FTAA	321	423	44	36
NAFTA	265	353	36	30

FTAA Excluding NAFTA	56	70	8	6

Source: International Monetary Fund, *Direction of Trade Statistics*, 2001.

TABLE 2
Trade Percentages for FTAA Countries in 2001

	Exports to FTAA/ Total Exports	Exports to U.S./ Total Exports	Imports from FTAA/ Total Imports	Imports from U.S./ Total Imports
Antigua and Barbuda	3.6	1.1	29.4	19.2
Argentina	57.8	10.9	54.6	18.6
Bahamas	41.4	35.0	39.1	34.7
Barbados	62.2	15.0	70.9	42.1
Belize	53.2	36.1	61.7	41.7
Bolivia	74.0	13.9	73.9	16.6
Brazil	48.0	24.7	43.3	23.5
Canada	89.2	87.6	69.1	63.7
Chile	42.0	18.5	52.4	16.1
Colombia	86.1	43.5	62.6	34.7
Costa Rica	60.6	41.3	62.2	41.8
Dominica	66.8	6.0	73.7	36.3
Dominican Republic	89.8	86.5	79.9	58.6
Ecuador	65.6	38.6	63.2	27.8
El Salvador	88.3	18.8	77.4	34.3
Grenada	48.6	29.9	71.3	33.8
Guatemala	82.7	57.6	66.9	33.8
Guyana	53.5	21.6	59.1	23.8
Haiti	93.3	84.3	77.7	55.9
Honduras	81.2	69.8	73.4	54.5
Jamaica	50.8	30.9	71.5	47.2
Mexico	93.8	88.5	73.2	67.6

Nicaragua	76.5	53.7	76.7	25.0
Panama	73.2	49.7	66.4	32.9
Paraguay	67.5	2.8	75.7	16.8
Peru	47.2	25.4	64.7	30.5
St. Kitts and Nevis	28.7	24.5	79.9	44.4
St. Lucia	50.7	33.5	84.9	20.9
St. Vincent and the Grenadines	24.8	11.5	33.5	12.8
Suriname	43.7	26.1	53.3	34.0
Trinidad and Tobago	87.2	58.1	60.8	40.3
United States	44.0	—	35.8	—
Uruguay	65.8	9.3	58.0	11.8
Venezuela	66.4	53.8	59.5	32.7

Source: International Monetary Fund, *Direction of Trade Statistics*, 2001.

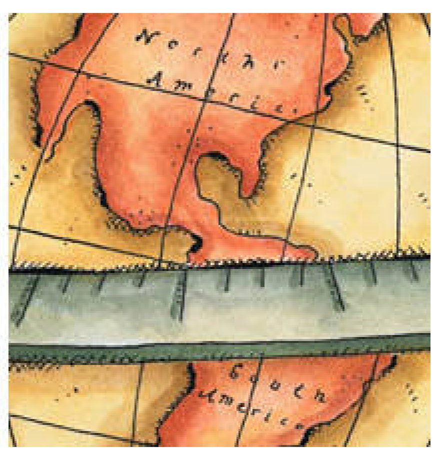
Challenges facing the FTAA process

The diversity of issues under negotiation, compounded by the task of finding a consensus among 34 nations, is only one of the challenges to the formation of the FTAA. There are other obstacles that need to be surmounted in order for the FTAA to become a reality.

One challenge involves the FTAA's allowance for other trade agreements in the hemisphere. According to analysts, the role of these agreements in the FTAA context needs to be defined. Countries in the hemisphere are members of 20 free trade agreements as well as four customs unions that span the region. These agreements, according to Jagdish Bhagwati of Columbia University, an eminent trade economist, can become a "spaghetti bowl" of conflicting arrangements. The current negotiations for the formation of the FTAA present an opportunity to simplify these arrangements under a single agreement.

Another concern, mentioned in many official FTAA documents, is that smaller partners in the hemisphere be given special assistance. This concern may be well founded: Some skeptics of the process claim that the success of the FTAA depends on the agreement reached between the hemisphere's two largest economies, Brazil and the United States. The current U.S. strategy of negotiating multiple free trade agreements at once, however, should help mitigate this concern.

FOR THE DEVELOPING COUNTRIES OF THE WESTERN HEMISPHERE, THE FTAA OFFERS HOPES OF INCREASED FOREIGN DIRECT INVESTMENT, INCREASED PRODUCTIVITY, THE SHARING OF TECHNOLOGY, AND HIGHER WAGES AND STANDARDS OF LIVING.



Yet another challenge revolves around agricultural issues. According to the World Bank, agriculture makes up, on average, 7 percent of Latin America's GDP and a considerably larger component of its exports. The United States recently extended its agricultural subsidy program with the enactment of the Farm Security and Rural Investment Act of 2002. (See the cover story). Agricultural subsidies and quotas are a major irritation for Latin American exporters, and a gradual reduction in the level of U.S. agricultural trade protection may be needed if an agreement is going to be reached.

One potential concern is the institutional structure of the agreement, which must be capable of producing clear and stable rules. For instance, one of the drawbacks of Mercosur is that the member countries frequently change the agreement's rules and the tariff level and structure. In many cases, members have altered the rules of the agreement on a unilateral basis. The ongoing use of these types of changes needs to be minimized for the FTAA to be successful.

A major challenge facing the FTAA is the political instability that has historically plagued a number of Latin American countries. This instability can affect not only the course of the negotiations but also the stability of the FTAA. In early 2002, a meeting of government officials in Venezuela had to be cancelled because of the attempted coup against the country's president, Hugo Chavez. However, the FTAA could have a stabilizing effect on the region since it allows only democracies to participate in the trade bloc.

Business cycle conditions will also play a significant role in the shape of the final agreement. Countries often turn to protectionist policies when experiencing economic downturns and liberalize trade during expansions. The success of the FTAA will depend in part on its ability to look beyond short-term cyclical behavior.

One final obstacle toward implementing the FTAA is that congressional approval is needed for the United States to become part of the agreement. Thus, the final implementation of the FTAA will depend on U.S. political will and the potential influence of special interest groups. History shows that this approval process may not be an easy one — the U.S. Congress passed NAFTA by only a very narrow vote in 1993.

But a potential showdown in the U.S. Congress may be avoidable. Article 24 of the General Agreement on Tariffs and Trade (GATT) allows WTO members to exclude certain sectors from trade liberalization in free trade agreements. The sectors excluded from free trade usually are politically sensitive and have particularly powerful lobbies. This clause serves as a pressure valve that may ultimately make the agreement palatable to all parties.

The FTAA is perhaps the most ambitious economic initiative in the Western Hemisphere's history and one that would have a tremendous effect on the lives of its inhabitants. Many roadblocks and detours will likely have to be faced before it is completed.

This article was written by Francisco Parodi, a senior economic analyst in the Latin America Research Group of the Atlanta Fed's research department.

FTAA Negotiations Cover Broad Spectrum of Issues

Negotiations for the FTAA, which began in Santiago, Chile, during the second Summit of the Americas in 1998, are explicitly designed to take into account the differences in levels of development and size of the economies.

Guiding principles
There are six principles guiding the negotiations:

- Decisions will be made by consensus.
- Negotiations will be conducted in a

- Government Procurement: To achieve a framework that ensures openness and expanded access to government procurement markets.
- Dispute Settlement: To set up an international arbitration body with clear guidelines to solve both government and private disputes.
- Agriculture: To set up the necessary sanitary rules governing agricultural trade, to eliminate export subsidies, and to identify and "discipline" other subsidies

transparent manner.

- The FTAA will be consistent with WTO rules and disciplines.
- The FTAA will be a single undertaking — that is, "nothing is agreed until all is agreed."
- Regional trade agreements such as the Central American Free Trade Area, the Andean pact, Mercosur and NAFTA can co-exist with the FTAA. In other words, the creation of a hemisphere-wide agreement does not imply the consolidation into a single free trade area.
- Special attention will be given to the needs of the smaller economies. This principle is particularly important for some Caribbean states whose main sources of government revenue are import tariffs.

Negotiating groups

The Trade Negotiations Committee meets at least twice a year at rotating sites throughout the hemisphere. The negotiations are conducted through nine groups that address a wide range of issues. (For more information, visit the FTAA Web site at www.ftaa-alca.org/.) These negotiating groups and their objectives are

- Market Access: To progressively eliminate tariffs and nontariff barriers such as quotas.
- Investment: To negotiate rules governing taxation of foreign capital and capital controls.
- Services: To establish disciplines to liberalize trade in services across the hemisphere to ensure certainty and transparency.

that function as export subsidies.

- Intellectual Property Rights: To promote and ensure protection of intellectual property rights, with special attention to changing technology.
- Subsidies, Dumping and Countervailing Duties: To develop clear rules and procedures regarding the application of trade remedy laws to avoid the creation of unjustified trade barriers.
- Competition Policy: To ensure that the FTAA liberalization process is not undermined by anticompetitive business practices.

Special committees

In addition to the nine negotiating groups, special committees were set up that are unique to the FTAA. Two of these groups are of particular interest. The first is a consultative group on smaller economies that provides technical assistance and resources to the smaller members of the FTAA. The second group includes the participation of civil society to voice its concerns about the potential effects of the FTAA. This committee was formed in response to the increasing influence of nongovernmental organizations (NGOs) in the political process. Negotiators meet with the NGOs on a regular basis to consider their concerns about possible negative consequences of the FTAA.

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